No. 12,803

IN THE

United States Court of Appeals

For the Ninth Circuit

FRED C. HALL,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Review of a Decision of the Tax Court of the United States.

PETITION FOR A REHEARING.

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Table of Authorities Cited

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To the Honorable William Denman, Chief Judge, and to the Honorable Associate Judges of the United States Court of Appeals for the Ninth Circuit:

Fred C. Hall, Petitioner in the above cause, hereby petitions this Honorable Court for a rehearing herein and a reconsideration of its affirmance of the Tax Court, per curiam filed herein on February 29, 1952.

The rehearing is sought on the following grounds:

1. The Tax Court decision herein is irreconcilable with this Court's decision in *Chaplin v. Commissioner* (C.C.A. 9th, 1943), 136 F.(2d) 298.

This Court's per curiam affirmance in the instant case creates a conflict in the decisions of this Circuit

and leaves a rule of law of great importance to practitioners in a highly unsettled state.

2. In view of the determination by this Court that the validity of the stock under Ohio law was not properly before the Tax Court, the issue here presented is merely the legal effect of facts established by uncontradicted and unimpeached testimony and by documentary evidence of unquestioned validity. In the absence of conflicting testimony and in the absence of impeaching evidence or factual circumstances conflicting with the testimony, this Court should determine *as a matter of law* whether the ultimate conclusion of the Tax Court is fairly supported by the record, whether that determination is characterized as legal, factual or mixed. If the *Chaplin* case, cited supra, is to be repudiated, the moving considerations should be stated. If it is to be distinguished, any valid distinguishing factors should be made explicit, rather than being concealed in the misty shroud of per curiam affirmance of a foggy decision.

3. The documents and testimony introduced in this case are certainly sufficient to establish prima facie that the stock was issued to Petitioner in 1942 and pledged back by him to the corporation. If the evidence on this subject does not compel such conclusion, it is unquestionably sufficient to overcome the presumptive correctness of the Commissioner's contrary determination, thus rendering the matter one for decision on the evidence.

The evidence consists of the employment contract and Petitioner's uncontradicted, unimpeached testi-

mony consistent with all circumstances revealed by the record.

Petitioner most emphatically urges that a prima facie case is thus made out requiring the Commissioners to proceed with rebutting evidence or destructive factual analysis, neither of which burdens has in any sense been met.[1] It is therefore, as a matter of law, established that the stock was issued in 1942 and pledged back to the corporation in that year. It cannot be maintained consistently with *Chaplin v. Commissioner,* and *Luther Bonham* (1936) 33 B.T.A. 1100, affirmed *Bonham v. Commissioner* (C.C.A. 8th, 1937), 89 F.(2d) 725, cited and discussed in Petitioner's Brief at pages 25 through 30, that such transaction does not constitute the realization of income in 1942. To distinguish this case on so-called "factual" grounds in the face of a record free of substantial factual conflict is to draw a distinction without a difference.

4. The result of this Court's affirmance of the Tax Court decision in this case is a reversion to the legislatively repudiated Dobson rule[2] under which, if sufficiently confused, a Tax Court decision would not be reversed no matter how erroneous. The Tax Court decision is infected with clear legal and factual errors so inextricably interwoven into the fabric of the

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[1]Cf. *Grace Brothers v. Commissioner of Internal Revenue* (C.C.A. 9th, 1949), 173 F.(2d) 170.

[2]*Dobson v. Commissioner* (1943), 320 U.S. 489; I.R.C. § 1141, as amended by P.L. 773, § 36, 80th Cong., 2nd Session, was intended to "[remove] all traces of the Dobson decision". (From House Debate, as reported by 1952 Prentice Hall Federal Tax Service, Par. 21,820.)

decision that when such errors are removed the remains are adequate to support no conclusion whatsoever.

In brief support of this position reference may be made to the following:

(a) The erroneous reliance upon the supposed effect of Ohio corporation law (Tr. pp. 46 and 47).

(b) Apparently regarding the time of rendition of services as controlling the time of realization of income (Tr. p. 46) despite the prior correct statement of the law that time of receipt controls regardless of time of rendition of services (Tr. p. 42).

(c) The conclusion, apparently on the basis of the Court's views as to how things ought to be, despite a record entirely to the contrary, that the stock was issued entirely or primarily for services to be rendered in the future rather than as consideration for Petitioner's participation in the new venture (Tr. p. 46; Petitioner's Brief pp. 13 through 20).

(d) The Tax Court's cavalier disregard of fundamental principles of corporation and securities law in its statement (Tr. p. 43) that Petitioner had no dominion or control over the shares and could not sell them prior to 1943 and 1944; indeed this disregard of such legal fundamentals permeates and invalidates the entire decision.

(e) The Tax Court's failure to make any findings on the vital questions of share issue and pledge and the making of purported ultimate findings that the petitioner "became the unrestricted owner . . . in 1943

[and 1944] in exchange for services which he rendered to the company [in such years]" which purported findings serve rather to conceal than disclose the factual basis for the Tax Court's determination.

(f) The Tax Court's statement (Tr. p. 43), erroneous if relevant, that there is no evidence as to the company's capital structure, its assets and liabilities, and who dictated its policies. The record shows without dispute or contradiction that petitioner was one of four organizers of the venture; it shows exactly what stock was issued, and for what consideration, (Eg. Tr. p. 21) and all conceivably relevant material regarding control, capital structure, and asset and liability position, is contained in or inferrable from these facts. The fair market value of $100.00 per share in 1942 was not in issue (Tr. p. 12) and the ultimate selling price of $150.00 per share was established. (Tr. p. 20.) The possible relevance of evidence on these points is not disclosed; such references in the Tax Court's opinion apparently are intended only to suggest that the taxpayer did not make a sufficiently full factual development to earn a favorable decision.

But the record shows fully, clearly, and beyond a doubt, that the taxpayer presented a full and fair disclosure of facts more than sufficient to establish prima facie the issuance of the stock to him in 1942 and the pledge thereof to the corporation as security for the performance of contractual obligations. The petitioner fully and fairly answered all questions of Government counsel as well as the rather extensive

questions of the Tax Court. Under such circumstances reliance on the absence of matters of evidence referred to in the Tax Court opinion (Tr. p. 43, First Paragraph) is ridiculous, unfair, and contrary to recognized standards as to what constitutes a prima facie sufficient showing.

(g) Though there is more merit to the Tax Court's references to the absence of evidence on dividend and voting rights, much the same observations are soundly applicable. From a showing of share issue—share issue at an undisputed fair market value (Tr. p. 12)—and pledge of the shares, *share ownership together with incident rights follows as a matter of law,* (see discussion in Petitioner's Brief, pp. 8-11, and authorities there cited) absent some showing to the contrary. If after the prima facie showing of share issue and ownership made by petitioner, opposing counsel or the Tax Court were in doubt regarding dividend and voting rights, inquiry could have been made. With the showing of share issue and ownership necessarily implicit in this record under a proper appreciation and application of principles of corporation law, the Tax Court's adverse conclusions with regard to dividends and voting rights are not supported by anything in the record, but rest entirely on extrajudicial considerations.

The taxpayer's burden of proof can only be to present a legally sufficient case and meet conflicting evidence, if any. The decision herein would impose not only that burden of proof but the further require-

ment of negativing all possible unfavorable inferences which could be drawn from the absence of any conceivably material items of evidence. The imposition of such a burden of proof is arbitrary, unfair, and contrary to law.

5. The decision herein abandons the clear, sound, simple and predictable intent rule[3] of the *Chaplin* case, cited supra, and replaces it with a rule which is no rule at all but which permits the Tax Court to impose taxes, not on the basis of what was done as shown by evidence judicially adduced, but rather on the basis of what it thinks would have been more sensible or reasonable to do, or what subsequently reconstructed transaction would yield the most revenue in a particular case.[4] A decision with such predicates should not be permitted to stand.

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[3]"As stated in an opinion of the Second Circuit determining the incidence of a tax on income, 'It is elementary that title passes when the parties intend that it shall pass and such intention is to be gathered from the contract and the conduct of the parties * * *' " *Chaplin v. C.I.R.* (C.C.A. 9th, 1943) 136 F.(2d) 298, at 301.

[4]The confusion in this area of law, and the inconsistency of the positions taken by the Government is well illustrated by the decisions discussed in the Tax Court opinion and in the briefs. In addition, attention is invited to two recent decisions.

In *Artis C. Bryan* (1951), 16 T.C. No. 120, taxpayer cited the Tax Court's decision in the instant case for the proposition that certain income in the form of stock was realized in 1943 when restrictions on ownership and disposition were removed. Held: the stock had been "actually received * * * in 1940. Presumably [!] he was entitled to vote it [and receive the dividends on it]."

In *Robert Lehman* (1951), 17 T.C. No. 72, the taxpayer "received" stock in 1943, but his ownership was so restricted that the stock then had no ascertainable market value *and therefore* did not then give rise to income. Against the Commissioner's contention that income was realized on the release of said restrictions, the Tax Court held that the release of restrictions, whereby the

6. This Court cannot permit the fineness of the line between taxability in 1942 as against taxability in 1943 and 1944 to deprive Petitioner of the right to have his case properly classified on the side on which it clearly falls. In a transaction producing ordinary income, Petitioner became the owner of shares then worth $5,000.00, in 1942, and he properly reported the $5,000.00 as ordinary income for 1942. He is factually, legally, and morally entitled to be sustained.

Dated, San Francisco, California,
March 28, 1952.

FREED, GEBAUER & FREED,
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taxpayer became "the unrestricted owner (cf. the ultimate findings of 'fact' herein) of the shares", was not a taxable event.

If the stock in the instant case was issued and pledged (as was the plain intent of the parties) then the *Hall* decision holds, contrary to the *Lehman* case, that the release of restrictions is a taxable event.

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco, California,
March 28, 1952.

SCOTT FLEMING,
Of Counsel for Petitioner.